No. 9837

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, Trustee of the John and Pauline Tonningsen Trust, Petitioner,	
vs.	
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	

Upon Petition to Review a Decision of the United States Board of Tax Appeals.

BRIEF FOR PETITIONER.

J. W. RADIL,
F. J. KILMARTIN,
R. M. SIMS, JR.,
KNIGHT, BOLAND & RIORDAN,
444 California Street, San Francisco,
Attorneys for Petitioner.

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JURISDICTIONAL STATEMENT.

This appeal involves asserted deficiencies in federal income taxes for the taxable years 1935 and 1936 in the respective amounts of $4610.65 and $1713.74. The case comes before this Court on petitioner's petition for review (Tr. 15-18) and an agreed statement settled pursuant to Rule 76 of the Federal Rules of Civil Procedure and Rule 30 of this Court (Tr. 1-62), after decision by the United States Board of Tax Appeals entered pursuant to an opinion promulgated December 10, 1940 and reported at 43 B. T. A. 37 (Tr. 25-43).

Jurisdiction of the United States Board of Tax Appeals is based upon Internal Revenue Code, sec. 1101 (Act of Feb. 10, 1939, c. 2, sec. 1101; 53 Stat. 158) and section 272 of the Revenue Acts of 1934 and 1936 (Act of May 10, 1934, c. 277, section 272; 48 Stat. 741, and Act of June 22, 1936, c. 690, section 272; 49 Stat. 1721; see: Internal Revenue Code, section 272). Petitioner, pursuant to said statutes, filed with said Board its petition for a redetermination of the deficiencies proposed by respondent (Tr. 4).

Jurisdiction of this Court is predicated upon Internal Revenue Code, sections 1141 and 1142 (Act of Feb. 10, 1939, c. 2, sections 1141 and 1142; 53 Stat. 164, 165). Petitioner, pursuant to said statutes, filed with said Board its petition for review of the Board's decision (Tr. 2, 15-18).

STATEMENT OF THE CASE.

STATUTES INVOLVED.

Statutes involved for the year 1935 are:

Revenue Act of 1934, section 22(a), 23(o), 162, and 167 [Act of May 10, 1934, c. 277, sections 22(a), 23(o), 162 and 167; 48 Stat. 686, 688, 728 and 723; 28 U.S.C.A., Internal Revenue Acts, pp. 669, 674, 725 and 727].

Statutes involved for the year 1936 are:

Revenue Act of 1936, sections 23(o) and 162 [Act of June 22, 1936, c. 690, sections 23(o) and 162; 49 Stat. 1658 and 1706; 28 U.S.C.A., Internal Revenue Acts, pp. 829 and 893].

The text of these statutes is set forth in an appendix.

QUESTIONS INVOLVED AND THE MANNER IN WHICH THEY ARE RAISED.

The questions for the respective years 1935 and 1936 present different issues and hereafter will be dealt with separately.

1935.

The chief question in reference to the year 1935 is whether petitioner is entitled to a deduction, under the provisions of section 162(a) of the Revenue Act of 1934, of capital gains realized by it during that year as gross income, which, pursuant to the terms of the deed creating the trust, was, during the taxable year, permanently set aside for or to be used for charitable purposes in accordance with the provisions of said Act.

This question arises by virtue of the inclusion of the sum of $32,785.40 in the taxable income of petitioner as recognizable capital gains.

During that year petitioner held the assets of the trust, from the sale and reinvestment of which the gains arose, for the benefit of six charitable organizations, subject to the payment of the ordinary income (exclusive of capital gains) therefrom to one life beneficiary thereof during her life and, upon her death, to the payment of charges against the trust estate, to the payment from principal of specific sums to named individuals and to the payment from ordinary income of specific monthly payments during the respective lives of other named individuals. The deed creating the trust also provides:

> "Should the said Second Trustor [the life beneficiary] be in need of a greater amount than said net income for her care, maintenance and support, or by reason of illness or other emergency, the Trustee [petitioner] may, in its absolute discretion, pay to her, out of the principal of the trust fund and estate, such additional amounts as it may deem necessary and appropriate for the purposes aforesaid, and no one, howsoever interested in the Trust shall be competent to object thereto." (Tr. 5, 27-30.)

The ordinary income from the trust estate was over double the existent or possible needs of the life beneficiary for her care, maintenance, and support and for her expenses as an invalid. The charges, and specific bequests payable on the death of the life beneficiary, could by no stretch of the imagination exhaust the trust estate.

There was paid, however, to the life beneficiary sums aggregating $9545.80 from the principal of the trust estate in 1935. These payments were not made in the exercise of the discretion vested in petitioner, but after its refusal to pay more than the ordinary income, and only with the consent of the charitable remaindermen.

The Board of Tax Appeals held in effect that the fact that payments were actually made from corpus conclusively showed that the capital gains were not deductible. It did not determine whether such payments were made pursuant to the terms of the trust instrument. It did not determine whether the economic benefit represented by the capital gains would

go to the charities pursuant to the terms of the trust. It did not determine whether or not the corpus of the trust, pursuant to the terms thereof and the applicable facts, was free from invasion.

In view of the position taken by the Board of Tax Appeals, petitioner has herein further attempted to show that if the conclusions of the Board are upheld (that is, if the right to the deduction is lost because of actual payments made, regardless of the provisions of the terms of the trust), the income represented by the capital gains was in reality taxable to the life beneficiary of the trust by virtue of the fact that she was also a grantor of the trust. Consequently, if the findings of fact of the Board are sustained, petitioner submits that the income was taxable under section 167 of the Revenue Act of 1934 and under section 22 of the Revenue Act of 1934 and the principles enunciated in the case of *Helvering v. Clifford,* 309 U. S. 331, 84 L. ed. 788. Although this point was not made before the Board of Tax Appeals, the failure of the Board to find on the issues presented and the criteria of judgment followed by the Board make it necessary to raise this point before this Court.

Petitioner, however, chiefly relies upon the point first stated above and has attacked all of the findings of fact and conclusions of the Board and the failure of the Board to find upon issues which it deems relative (Tr. 18-22).

1936.

The questions in reference to the year 1936 are, first, whether, by reason of the provisions of the trust, there should be included in petitioner's taxable income sums paid by it to the legal representative of the estate of the deceased first trustor in satisfaction of a controversy regarding the liability of the trust for contribution for federal estate taxes and state inheritance taxes arising on the death of said trustor and paid by his executors, which said sums petitioner purported to pay out of the principal of the trust, and whether there should be an attendant denial of a deduction under section 162(a) of the Revenue Act of 1936, of amounts which petitioner purported to pay out of income to charitable beneficiaries of the trust; and, second, whether, by reason of the provisions of the trust, there should be included in petitioner's taxable income sums paid by it for legal expenses attendant to securing a reduction in federal estate taxes, which said sums petitioner purported to pay out of the income of the trust.

The life beneficiary of the ordinary income of the trust died on January 25, 1936. For all practical purposes the trust can be considered, during the year 1936, as administered for the charitable beneficiaries subject to the payment from ordinary income of the specific sums to the respective individuals named and subject to the specific payments directed to be made on the death of the life beneficiary. Respondent has in effect conceded this point, as there is no question but that the capital gains realized upon the sale of securi-

ties to secure funds to make the specific payments last referred to were permanently set aside for the charitable beneficiaries of the trust.

During the year 1936 petitioner paid from the principal of the trust estate the sum of $18,533.86 to the executors of the estate of John Tonningsen. This sum was paid in settlement of a controversy regarding the liability of the trust estate for federal and state taxes arising on the death of John Tonningsen, who had died November 28, 1933. Petitioner paid this sum out of the principal of the trust estate and paid out the net ordinary income to the charitable beneficiaries. Petitioner contended and contends that the payments were properly made from the principal of the trust estate pursuant to the terms of the instrument creating the trust, and that respondent has erred in charging this sum back against income for tax purposes.

During the year 1936 petitioner paid out the sum of $6000.00 from income for attorneys' fees; and credited the principal account of the trust and charged the income account with an additional $1500.00 representing sums theretofore paid out of principal on account of attorneys' fees. Petitioner claimed the sum of $7500.00 as a deduction on the return filed. A recent decision of the U. S. Supreme Court has indicated that this expense is not deductible under section 23(a) of the Revenue Act of 1936, as a business expense (*City Bank Farmers Trust Company v. Helvering*, Nos. 408 and 409, April 28, 1941, 85 L. ed. 788).

Nevertheless, petitioner contends that the sum represented thereby should not be included in the taxable

income for the year 1936, because the payment of these attorneys' fees constitutes a payment for charitable purposes and is deductible within the provisions of section 162(a) of the Revenue Act of 1936.

The two questions in regard to the year 1936 are presented here by petitioner's attack on the findings of fact and conclusions of law made by the Board (Tr. 22 to 25).

SPECIFICATION OF ERRORS.

1935.

Petitioner has attacked all of the findings of fact and conclusions of law which the Board particularly relied upon in denying the claimed deduction for 1935. These specifications may be conveniently summarized here as follows:

I.

> The Board of Tax Appeals erred in its decision that there is a deficiency in petitioner's income tax for the year 1935. [Statement of Points, 1935, point I (Tr. 18); see Argument, 1935].

The first point of attack on this general conclusion is as follows:

II.

> The Board of Tax Appeals erred in its decision that the capital gains realized in 1935 are not deductible under the provisions of section 162(a) of the Revenue Act of 1934 as income permanently

set aside or to be used for charitable purposes. [Statement of Points, 1935, points II A, III A, and IV A (Tr. 19-21); see Argument, 1935, point I].

It cannot be determined whether in reaching the conclusion last complained of the Board relied upon the payments made to the life beneficiary as in themselves defeating the authorized deduction, or as merely conclusively demonstrating that the gains pursuant to the terms of the trust were not set aside nor to be used as provided in the law. Consequently petitioner alleges as errors:

III.

The Board of Tax Appeals erred in its decision that the actual payments themselves defeated the charitable deduction, or that there was such a possibility of payments under the terms of the trust as would defeat the charitable deduction. [Statement of Points, points II B(1) and (2), II C(1), (1b) and (2), II D(1), (2) and (3), II B, II C, IV B(1) and (2), IV C and IV D (Tr. 19-22); see Argument, 1935, point I B].

As alternative grounds of error, if the conclusions of the Board are upheld from the facts petitioner alleges:

IV.

That the Board of Tax Appeals erred in including in petitioner's gross income capital gains to an extent greater than an amount actually

paid out by petitioner. [Statement of Points, points II A and IV A (Tr. 21); see Argument, 1935, point II].

V.

That the Board of Tax Appeals erred in including capital gains in the net income of petitioner when the income represented thereby, according to the Board's conclusions, was subject to control by the grantor of the trust. [Statement of Points, point I (Tr. 18); see Argument, 1935, point III].

1936.

Petitioner has similarly attacked all of the decisive conclusions of fact and law in reference to the year 1936. In view of the recent Supreme Court decision referred to above, petitioner no longer contends that the attorneys' fees paid from income in 1936 are deductible as a business expense, and the errors set forth in Statement of Points, 1936, points II B(1) and (2), III B, and IV B are consequently waived. The remaining alleged errors can be summarized as follows:

I.

The Board of Tax Appeals erred in including in the net taxable income of petitioner the amount paid from principal of the trust in compromise of a dispute with the executors of the estate of the first trustor, and in the attendant denial of a deduction of amounts paid from income to the

charitable beneficiaries. [Statement of Points, 1936, points I, II A(1), (2), (3) and (4), II C, III A(1), (2), (3) and (4), III C, IV A, and IV C (Tr. 22-25); see Argument, 1936, point I].

II.

The Board of Tax Appeals erred in denying the full deduction of the amounts paid to charities or on their behalf from income during 1936. [Statement of Points, 1936, points I, II C, III A(5), III C and IV C (Tr. 22-25); see Argument, 1936, point II].

ARGUMENT.

1935.

SUMMARY.

As pointed out above the Board of Tax Appeals made the payments disbursed from principal in 1935 the sole criteria of whether or not the gains realized in 1935 were permanently set aside or to be used exclusively for charitable purposes within the statutory deductions afforded by section 162(a) of the Revenue Act of 1934. Of course error in this regard would not be determinative if respondent's determination may be upheld on other grounds. Petitioner has therefore outlined below (Point I A) the decisions and principles applicable to the construction of section 162(a), and has further analyzed the facts, not only

to show that payments actually made did not defeat the deduction, but also that the provisions of the trust and the facts to which they must be applied demonstrate that petitioner was entitled to the deduction (Point I B).

If petitioner is in error as to its interpretation of the law and facts, the conclusions of the Board remain. It is submitted that these conclusions indicate, if actualities rather than provisions of the trust agreement are to govern this case, either (1) that all of the gains except a sum not in excess of $3070.62 were actually set aside for the charitable beneficiaries (Point II), or (2) that all of the gains not so set aside were so subject to invasion by the life beneficiary of the trust that they were taxable to her as a grantor of the trust (Point III).

I.

THE CAPITAL GAINS REALIZED IN 1935 ARE DEDUCTIBLE UNDER THE PROVISIONS OF SECTION 162(a) OF THE REVENUE ACT OF 1934.

A. UNDER THE PROVISIONS OF SECTION 162(a) CAPITAL GAINS ARE PERMANENTLY SET ASIDE OR TO BE USED EXCLUSIVELY FOR CHARITABLE PURPOSES WHEN THE GAIN MEASURED THEREBY WILL ACCRUE TO CHARITABLE PURPOSES.

The income involved for the year 1935 is recognizable capital gains in the sum of $32,785.40. Under the law of the State of California, in the absence of any contrary expressions of intent in the instrument creating the trust, these gains are to be regarded as

part of the corpus of the trust and are not available to the life beneficiary (*Estate of Gartenlaub,* 198 Cal. 204 at p. 213, 244 P. 348 at p. 351; *Estate of Canfield,* 104 Cal. App. 181, 285 P. 363, 28 Calif. Law. Rev., 34 at p. 54, November, 1939).

Section 162(a) of the Revenue Act of 1934 provides as follows:

> "The net income of the estate of trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—
>
> "(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o) or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit."

In order to determine whether such gains are permanently set aside for or to be used exclusively for charitable purposes reference must be had to the provisions of the instrument creating the trust which refer to the disposition of corpus. The trust provisions must be considered in the light of the interpretation to be given the words "permanently" and "exclu-

sively" as used in the statute, and, in turn, some consideration must be given to interpretation of the phrase "set aside" as applied to income in the form of capital gains which by its nature is not the subject of specific identification.

Several possibilities suggest themselves:

In the first place, if the right to both income and principal of a trust are vested in charitable beneficiaries there could be no question but that accretions to the principal would be set aside for the benefit of the charitable beneficiaries.

Where there is an outstanding life interest to the income of a trust, with the remainder over to charitable beneficiaries, it could be argued that the accretions to principal were not permanently set aside, because of the possibility of frustration from economic reverses before the time of enjoyment. Reason and authority, however, demonstrate that in such a situation the income in the form of capital gains which becomes a part of the corpus of the trust ultimately to be received by charities, is deductible under the provisions of section 162a.

The Board of Tax Appeals has said:

> "It seems clear to us that if the income [from the capital gain] should be reduced by the amount of the proposed tax, merely because certain beneficiaries are for life entitled to receive the income from the reinvestment thereof, the loss occasioned thereby would fall directly upon * * * the exempt corporation. It is our opinion, therefore, that the income in question is deductible under the pro-

visions of section 219(b) [Revenue Act of 1918] in determining the net income of the estate, for to hold otherwise 'would destroy the beneficient purpose of Congress'. *Lederer v. Stockton,* 260 U. S. 3".

Peoples Trust Co., Trustee, 10 B.T.A. 1385, 1393.

The Treasury Department recognizes a deduction in such circumstances (General Counsel's Memorandum No. 10423; Cumulative Bulletin XI-2, p. 127, December, 1932).

An examination of other cases dealing with the accumulation of income, either in the form of capital gains or ordinary income, by a fiduciary for ultimate distribution to charitable beneficiaries, reveals that mere delay in the time of enjoyment will not defeat the deduction.[1]

When the corpus, of which the accumulated income becomes a part, pursuant to the terms of the instrument creating the trust, is subject to payments to other than charitable beneficiaries the battle flags are unfurled, and a wide field of controversy is disclosed. The Courts have looked to the intent of Congress and to several applicable analogies, in order to sustain the deduction when realities indicate that the income will ultimately be used for charitable purposes.

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1. *Slocum v. Bowers* (S.D., N.Y.), 15 F. (2d) 400;
Bowers v. Slocum (C.C.A. 2), 20 F. (2d) 350;
Beggs v. United States (Ct. Cl.), 27 Fed. Supp. 599, 607;
E. C. Johnson, Executor, 13 B. T. A. 850;
Hu L. McClung, et al., Executors, 13 B. T. A. 335;
Irving Bank-Columbia Trust Co., Executor, 8 B. T. A. 833;
Herbert Jermain Slocum, Executor, 6 B. T. A. 36;
Potter v. Bowers (C.C.A. 2), 89 Fed. (2d) 687;
E. Sohier Welch, et al., Trustees, 9 B. T. A. 1370.

The latest expression of the purpose of the adoption of the provisions of section 162a is that contained in *Commissioner v. Bonfils* (C.C.A. 10) 115 F. (2d) 788. The Court said:

> "The purpose of Congress in enacting section 162 of the Revenue Act of 1934 was to encourage charitable gifts. Like provisions have been judicially construed so as to further and not hinder their beneficient purpose. Lederer v. Stockton, 260 U. S. 3, 8, 43 S. Ct., 5, 67 L. Ed. 99; Old Colony Co. v. Commissioner, 301 U. S. 379, 384, 57 S. Ct. 813, 81 L. Ed. 1169; United States v. Provident Trust Co., 291 U. S. 272, 285, 54 S. Ct. 389, 78 L. Ed. 793. In Lederer v. Stockton, supra, the Supreme Court, in passing on whether income was received by a corporation operated exclusively for religious, charitable, scientific, or educational purposes, refused to adhere to the technical and formal provisions of a trust, saying, 'To allow the technical formality of the trust, which does not prevent the Hospital from really enjoying the income, would be to defeat the beneficient purpose of Congress'. In Old Colony Co. v. Commissioner, supra, the Supreme Court refused to narrowly construe section 162 of the Revenue Act of 1928, 45 Stat. 838, 26 U. S. C. A., Int. Rev. Acts, page 405, which is substantially like section 162 of the Revenue Act of 1934, and held that income paid for charitable purposes was deductible, although it was not paid technically pursuant to the terms of the will, giving heed to actualities rather than the strict letter of the will. In United States v. Provident Trust Co., 291 U. S. 272, 54 S. Ct. 389, 392, 78 L. Ed. 793, the court held that in determining the value of the devise

to charities, actualities rather than an arbitrary presumption should prevail."

See, also:

Slocum v. Bowers (S.D., N.Y.) 15 F. (2d) 400;

Bowers v. Slocum (C.C.A. 2) 20 F. (2d) 350;

and cases cited in foregoing quotation.

In interpreting the statute and applying it to a given situation, a balance must be struck between the expressed intent of Congress to encourage charitable gifts, and the discouragement of any plan whereby a settlor may accumulate funds for non-charitable purposes through the guise of this charitable deduction (see: *Colt v. Duggan* (S.D., N.Y.), 25 F. Supp. 268, at p. 273).

The question of whether income which is accumulated as part of the corpus of a trust should be denied the charitable deduction (section 162(a)) because there are other payments which will or may be made out of the corpus, is analogous to the question of whether income periodically paid out by the trustee should be denied the deduction for distributions (section 162(b)) because the payments represented thereby might, in the event of insufficiency of income, be made a charge on the corpus of the trust. In criticism of the doctrine under the latter question whereby the income is taxed to the trust and not the beneficiary, it has been noted that the Courts have adopted a more realistic approach to the former question (see, *Union Trust Co. of Pittsburgh v. Commissioner* (C.C.A. 3), 115 F. (2d) 86, certiorari denied March 10, 1941, 85 L. Ed. 662 and Note 49 Yale Law Journal, 1496, p. 1498).

Another analogy is suggested by those decisions which deal with the provisions of the Federal Estate Tax statute which grant a deduction for the amount of all bequests, etc., for charitable purposes (see, Internal Revenue Code, section 812(d) and prior statutes). In *Ithaca Trust Co. v. United States,* 279 U. S. 151, 73 L. Ed. 647, the Supreme Court considered whether the fact that the support and maintenance of the life tenant was made a charge on the corpus of the trust would defeat the charitable deduction. The Court concluded that the standard of support fixed was capable of ascertainment and that since the income was apparently sufficient to maintain the life tenant under that standard "There was no uncertainty appreciably greater than the general uncertainty that attends human affairs."

See, also:

First National Bank v. Snead (C. C. A. 3), 24 F. (2d) 186;

Lucas v. Mercantile Trust Co. (C. C. A. 8), 43 F. (2d) 39;

Millard v. Humphrey (W.D., N.Y.), 8 F. Supp. 784 (aff'd. (C. C. A. 2), 79 F. (2d) 107).

The latest decision in regard to income taxes is that of *Commissioner v. Bonfils* (C.C.A. 10), 115 F. (2d) 788, wherein the charges against corpus were annuities in amount approximately one-fifth of the annual ordinary income of the trust. As in this case, the income in question was capital gains which became a part of the corpus of the trust. The Court referred to the intent of Congress, as quoted above, to the Federal

Estate Tax rule mentioned above, to *Hartford-Connecticut Trust Co. v. Eaton* (C.C.A. 2), 36 F. (2d) 710 (infra), and to the reenactment by Congress of provisions identical with those here in question after that decision, and concluded as follows:

> "We, therefore, conclude that the question whether the corpus, including the capital gains, has been permanently set aside for charitable purposes should be determined by a consideration of the provisions of the will in the light of the actual facts respecting the amount of corpus set aside out of which annuities were to be paid, the income derived therefrom, the amount of annuities, and the degree of probability that corpus will be resorted to for annuity payments" (115 F. (2d) at p. 792).

The *Hartford-Connecticut Trust Co.* case (C.C.A. 2), 36 F. (2d) 710), referred to above had applied the doctrine of the *Ithaca Trust Co.* case to the field of income taxation and held that a provision for support out of corpus would not defeat a deduction of capital gains to be held for charitable remaindermen where it appeared it would never be necessary to rely on such provision.

See, also:

Hartford Connecticut Trust Co. v. Eaton (D. Conn.), 41 F. (2d) 69;

Hartford Nat'l Bank & Trust Co. v. Hartford Connecticut Trust Co. (D. Conn.), 20 A.F. T.R. 1325.

In view of the foregoing it would appear that if the income involved will actually reach the charitable

beneficiaries, the deduction is allowable, and will not be defeated because of a provision in the instrument creating the trust which theoretically permits recourse to a fund of which the income becomes a part, in the event income is insufficient. The cases relied upon clearly establish that the deduction is available if the fund, of which the income becomes a part, is wholly free from invasion as a practical matter.

Is the situation different when the fund is subject to invasion to an extent which is clearly determinable and which can in no event, exhaust it? Suppose, as in this case, the principal of the trust is subject to a life estate, and upon the termination thereof to the payment of sums aggregating less than one-seventh of its value to non-charitable beneficiaries, with the residue to charity. It can be argued that the portion of non-charitable purposes for which the fund may be used, as a portion of ink in a barrel of water, will color the whole, and that, therefore, any further addition to the whole will be stained with the same identification. [See dissenting opinion *Commissioner v. Bonfils,* 115 F. (2d) 788, 792.] On the other hand, it takes no lawyer, tax expert or judge, to appreciate that where the corpus as a whole increases in value, the benefit thereof accrues to the ultimate remaindermen, and not to the person or persons who have a fixed and determinable interest in the corpus. There is an indirect benefit to the latter, in that the security for their payment is enhanced, but the former are directly benefited, subject only to possible economic frustration, which, as phrased by Mr. Justice Holmes, is "no un-

certainty appreciably greater than the general uncertainty that attends human affairs".

These factors have been recognized by the Courts.

In *Hartford Connecticut Trust Co. v. Eaton* (D. Conn.), 29 F. (2d) 840, the case giving rise to the appeal reported in 36 F. (2d) 710 and referred to above, the Court did not adopt the estate tax principles followed by the Circuit Court, but concluded as follows:

> "If, therefore, under the terms of a will, income is payable to exempted beneficiaries, it may not be taxed, even though a power lodges in the trustee to divert it to nonexempt fields, because, under such circumstances, while it may become income to the personal beneficiary, nevertheless, until it actually accrues to him, it is not income to him. It therefore remains income ' to be used' for charitable purposes. Upon actual diversion, it may be taxable either as income of the trust or as income of the person to whom it was paid" (29 F. (2d) at p. 843).

In *Bowers v. Slocum* (C.C.A. 2), 20 F. (2d) 350, in upholding the charitable deduction in favor of an estate pending administration, where the residue was left to charities, the Court said:

> "The purpose of the Congress to encourage bequests to corporations of the character of the residuary legatees is made plain by the deductions provided for by section 219, and the purpose of the act of 1918 was to insure the taxation of incomes which would eventually go to taxable persons in a more accurate and enforceable manner than was possible under prior laws, but not to tax

incomes which would go to corporations of the character of the residuary legatees. * * *

Section 219(b) does not make the deduction depend upon the action of the executors in crediting the income from their books, but upon the permanent setting aside of the income by the will itself for corporations of the character in question. The question, therefore, resolves itself into this: Was the income received by the estate during the year 1919 permanently set aside for the residuary legatees by the will itself? * * *

* * * the income in question, in the case at bar, reaches the beneficiaries of the bounty of the testatrix through the executors, and, if that income should be lost or reduced in amount, the loss occasioned thereby would be that of the residuary legatees, and therefore the income which the government is proposing to tax is the income of the residuary legatees" (20 F. (2d) at p. 352).

In the same case the District Court had said:

"I think it reasonable to suppose that the income on which income taxes must be paid by an executor while the estate is in process of administration or settlement is only such income as is ultimately taxable as such and that the liability of income to taxation does not depend on where the legal title is vested but upon who is ultimately entitled to the property constituting that income" (*Slocum v. Bowers* (S.D., N.Y.), 15 F. (2d) 400, at p. 404).

In *Lederer v. Stockton,* 260 U. S. 3, 67 L. Ed. 99, the charitable beneficiary actually received the income by virtue of a loan agreement with the trustee. It was

argued that the income was taxable to the trust. The Court, however, said:

> "This residuary fund was vested in the hospital. The death of the annuitant would completely end the trust. For this reason, the trustee was able safely to make the arrangement by which the hospital has really received the benefit of the income, subject to the annuity. As the hospital is admitted to be a corporation whose income, when received, is exempted from taxation under section 11 (a), we see no reason why the exemption should not be given effect under the circumstances. To allow the technical formality of the trust, which does not prevent the hospital from really enjoying the income, would be to defeat the beneficent purpose of Congress" (260 U.S. at p. 8, 67 L. Ed. at p. 100).

Finally, it must be noted that the income in question here is a capital gain. From its nature it is not a specific article subject to definite identification. Since it arises on a sale or exchange it is impossible to determine what specific part of the proceeds of the sale or exchange represents return of invested capital and what specific part represents the gain or taxable income. It is, however, possible to measure the portion of the total value of the proceeds which represents the gain. It is this measurement which constitutes the taxable income and not the receipt of any specific property.

Conversely, it must follow that when the proceeds of sale or exchange from which a capital gain has been realized are "paid", or "permanently set aside" or "to be used exclusively", there is no specific property

involved which represents the gain or taxable income. In the case of a capital gain, Congress must have intended the phrase "any part of the gross income" to refer to the measurement of the gain.

Since the measurement of gain itself cannot be the subject of specific identification, it can only be said to be "paid", or "permanently set aside" or "used exclusively" to or for the person or persons whose interest is enhanced in value by an amount commensurate with the measured gain. In the case stated, and in this case, it would be the ultimate remainderman. Even though future economic fluctuations deprived the remainderman of the actual enjoyment of the amount of a capital gain realized in a particular prior year, it is permanently set aside to him and to be used exclusively for him in the prior year in the sense of a measurement of gain. It is one of the ebbs and flows in the tides of investment, sale and reinvestment which will determine the value of the remainder at any subsequent date. The transactions giving rise to the gain cannot be disregarded in tracing the ultimate value of the remainder. Consequently, so long as the amount of the gain will finally be available to the charitable beneficiaries under the practical administration of the trust, it should make no difference that a fixed portion of the corpus is appropriated for other purposes, which are unaffected by the gains.

It is, therefore, submitted that whether or not the capital gains for the year 1935 are deductible depends on whether or not the economic benefit represented thereby will ultimately be received by the charitable beneficiaries.

B. THE FACTS DEMONSTRATE THAT THE CAPITAL GAINS REALIZED IN 1935 ARE DEDUCTIBLE.

At the beginning of the year 1935, John Tonningsen having died in 1933, the trust was irrevocable. The beneficial interest in the residue of the trust was vested in the charitable organizations. The interest of the charitable organizations was subject, during the life of Mrs. Tonningsen: (1) to the payment of the ordinary income to her during her lifetime (Article IV); (2) to the possibility that if she should be in need, the petitioner in its discretion might pay her such additional amounts out of principal as it might deem appropriate and necessary for her care, maintenance, support, or illness or other emergency (Article IV); and, after her death; (3) to the payment out of ordinary income, or out of principal, if necessary, of the costs, expenses and taxes mentioned in paragraph (a) of Article VII of the trust; (4) to the payment out of undistributed income, or out of principal, of the sum of $104,000.00 to specific beneficiaries (Article VII, par. (b)); and (5) to the payment out of ordinary income of the sum of $600.00 monthly to specific beneficiaries during their lives (Article VII, par. (b)) [Tr. 5, 27-30].

At the time of the death of John Tonningsen, respondent valued the assets of the trust at $702,222.51. The trust estate was composed of real and personal property and yielded net income as follows:

1931	$70,970.00
1932	73,984.18
1933	47,693.67
1934	45,571.58
1935 (11 months)	45,938.85

The petitioner's account for the year 1935 reveals that, from ordinary income of the trust, taxable and exempt, realized during that year, $46,858.47 was paid to Pauline E. Tonningsen and $2,417.99 was on hand at the end of the year, payable to her [Tr. 5 and 6].

Under the foregoing provisions and the facts applicable thereto, to whom did the economic benefit represented by the capital gains pass? Or, under a more strict interpretation of the statute for whose benefit was the corpus, of which the gains became a part, to be held?

(1) Neither the Actual Payments Made, Nor the Discretionary Provision of the Trust Defeat the Deduction.

The beneficiary received payments from sums constituting the corpus of the trust in 1934 and 1935. The statute provides that the charitable deduction applies to "any part of the gross income, without limitation, which *pursuant to the terms of the will or deed creating the trust,* is during the year paid or permanently set aside, etc." (italics added). Reference must be had to the terms of the trust to determine the ultimate disposition of the income in question; and conversely reference must be had to the terms of the trust to determine whether the amount so paid out, which it is contended defeat the charitable deduction, were paid out pursuant to such terms. The mere caprice of the trustee acting alone or in conjunction with others cannot affect the taxable incidents flowing from the directions contained in the trust instrument.

Freuler v. Helvering, 291 U.S. 35, 78 L. ed. 634;
Bowers v. Slocum (C.C.A. 2), 20 F. (2d) 350.

This principle was recognized by the Board in this case in deciding the issues for the year 1936, when it said:

> "If, as respondent contends, the parts of the gross income in question were not, *pursuant to the deed creating the trust,* paid to the charities, the deduction would not be available." [Tr. 39, italics added.]

Even the dissenting opinion in the *Bonfils* case [115 F. (2d) 788, 793] was predicated on this principle.

As demonstrated above, the situation involved is analogous to that arising in connection with the Federal Estate tax deduction for charitable beneficiaries.

In *Millard v. Humphrey* (W.C., N.Y.), 8 Fed. Supp. 784 (affirmed, C.C.A. 2, 79 F. (2d) 107), the Court concluded that the estate was entitled to a deduction under the Estate Tax, and said:

> "There was no reasonable possibility of invasion of the principal at the time of Mr. Crosby's death. The fact that an invasion did actually occur to the extent of $6,900.00, by consent of the remaindermen, cannot affect the determination that at the time of decedent's death the necessity of such an invasion was not foreseeable. Turning to the actual facts, merely for corroboration of this determination, it is found that Mrs. Crosby received as income from the estate a total of $45,795.79, over a period of seventeen months, an average of over $20,000.00 per year. Between the date of her husband's death and her death, Mrs. Crosby's estate increased over $20,000.00. It is evident that the invasion was not necessary and

> would not have been allowed over objection by the remaindermen'' (8 Fed. Supp. at p. 787).

No mention of this proposition is contained in the opinion of the Board of Tax Appeals, except in so far as it can be implied therefrom that the payments were predicated upon the discretionary clause of the trust. Petitioner has attacked the findings of fact and conclusions of law of the Board in so far as they touch on the foregoing points (Statement of Points, 1935, II C 1, II C 2, II D 1, II D 2, II D 3, III B, III C, IV B, IV C, and IV D, Tr. 18-22).

(a) There Is No Warrant For a Finding that the Payments Made Were Made ''Pursuant to the Terms of the * * * Deed Creating the Trust''.

In 1935 the life beneficiary was a paralyzed bedridden invalid of the age of 82 years, living in a hotel and maintaining herself and her niece. Her medical expenses for the period from January, 1934, to her death in January, 1936, averaged about $62.00 per month. She had no servants other than the hotel afforded. The expenses of the services, rooms and meals furnished her and her niece for the period from November, 1933, to her death averaged less than $750.00 per month. Her only other needs for care, maintenance, or support or because of her illness were her clothing and the constant attendance of one nurse [compare Findings of Fact, Tr. 30, and Statement of Facts, Tr. 6], the cost of which was not shown. By no stretch of the imagination could her needs approach or exceed the almost $4000.00 per month which the income of the trust furnished her [Tr. 6].

It further appears that at the time of her death, shortly after the termination of the year in question, she left property of a value over $190,000.00. During the years 1934 and 1935 she apparently accumulated over $20,000.00 from payments made to her by the trustee [Tr. 7].

The Board made no findings as to the possible needs of the life beneficiary, but it is clear from the undisputed facts that the trustee would have no right to deem further sums necessary and appropriate for her care, maintenance, and support, or by reason of illness or other emergency, nor could she be said to be in need of a greater amount for such purposes. The income from the trust was over double the amount of her existent or possible needs for such purposes. The discretion conferred by the trust agreement is a legal discretion, and can only be exercised within the limits set forth. There are no applicable California decisions construing trust provisions analogous to those here in question. It has been determined that where a trustee is given discretion to make payments for support, maintenance, and education of a beneficiary it is no abuse of discretion for the trustee to refuse to make such payments when the beneficiary is receiving some support from other sources (*Estate of Smith,* 23 Cal. App. (2d) 393, 73 P. (2d) 239). It, therefore, appears that the trustee should, under California law, consider the beneficiary's other sources of support in determining whether additional payments are necessary. Under the general law of trusts, a beneficiary entitled to discretionary payments for support and maintenance is

only entitled to support and maintenance according to his "station in life".

California Civil Code, Section 2269;

Bogart, Trusts and Trustees, Vol. 4, p. 2351, sec. 812;

Hartford Conn. Trust Co. v. Eaton (C.C.A. 2), 36 F. (2d) 710;

Lucas v. Mercantile Trust Company (C.C.A. 8), 43 F. (2d) 39;

First National Bank v. Snead, (C.C.A. 3), 24 F. (2d) 186;

Millard v. Humphrey (W.D., N.Y.), 8 F. Supp. 784 (aff'd, C.C.A. 2, point conceded, 79 F. (2d) 107).

(b) The Evidence Shows that the Payments Were Made Out of the Funds of the Charitable Remaindermen and Not Pursuant to the Terms of the Trust.

The payments made in 1934, the year prior to the year in question, were made after refusal by the trustee, and only after the consent of the charitable remaindermen was secured [Tr. 8]. In December 1934 the attorney for the life beneficiary addressed a request to the charitable beneficiaries that sums be paid from principal sufficient to make the total payments average $5000.00 per month. In this request it was represented that the life tenant had voluntarily refrained from attacking the trust; that the income from the trust was something like $2200.00 per month (in fact about $3750.00 per month [Tr. 5]); that the life beneficiary was bedridden and trying to build up a fund for her relatives; that the bank refused to

make payments out of corpus without the consent of the remaindermen, and that she could not long survive [Tr. 8, 45 and 46]. Subsequently the charities consented to the payments requested and in 1935, the taxable year in question, $9545.80 was paid out of the corpus of the trust to the life beneficiary [Tr. 8]. Although the consent of the charitable remaindermen referred to the discretionary provisions of the trust and to the demand made by the life beneficiary, there is no acknowledgment therein that she was in need, nor is there any reference to the exercise of its discretion by the trustee. In fact, the consent to the payments was gratuitously granted as a benefaction regardless of the needs of the life beneficiary [Tr. 8, 47-50].

That the trustee was justified in refusing the life beneficiary's demand is manifest from the facts concerning her circumstances previously outlined. That the charitable remaindermen were the real parties interested in the corpus of the fund is manifest not only from the provisions of the trust instrument itself, but from the conduct of the trustee and the life beneficiary who both recognized this apparent fact in predicating action upon their consent.

Consequently, such payments as were made, or that might have been made in the future, were not made "pursuant to the terms of the * * * deed creating the trust". They were made from funds which "pursuant to the terms of the * * * deed creating the trust" were "permanently set aside" or to be used exclusively for charitable purposes. The diversion was made by the

charities of their own funds, and cannot affect the taxable incidents of the income of the trust.

The Board disregarded the foregoing facts and rested its decision upon the fact that actual payments were made. There is, however, not a scintilla of evidence to justify a finding that the payments were or should have been made "pursuant to the terms of the * * * deed creating the trust", and its findings and conclusions must therefore be disregarded.

(c) Even If It Could Be Said that the Payments Were Made Pursuant to the Terms of the Trust, the Charitable Beneficiaries Would Not Be Deprived of the Benefit of the Capital Gains.

At the time the corpus of the trust was enhanced by the capital gains in question, it had a value sufficient to produce income in excess of $49,000.00 and was appraised less than two years previously at a sum in excess of $700,000.00. Of this sum, aside from such sums as the beneficiary might be entitled to under the discretionary clause, about $100,000.00 was appropriated to specific bequests and miscellaneous charges were authorized for expenses, taxes, and the like [Tr. 5, 28-30]. The net residue which in the absence of invasion would pass to the charities can be taken at roughly $600,000.00. The average payments from corpus to the life beneficiary, as revealed over a two year period, were slightly less than $1200.00 per month [Tr. 8]. At this rate it would take over 40 years for the life beneficiary to exhaust the residue of the corpus. In other words, it has to be presumed that the invalid life beneficiary would live to an age in excess of 120 years before the residuary rights of the

charitable remaindermen would be defeated. If their rights to the residue would not be defeated certainly they, and they alone, would reap the benefit of any accretions to corpus. It is submitted that if the charitable remaindermen would secure this benefit, the recognizable gain by which it is measured is set aside and to be used exclusively for them even though the corpus as it existed, before and after the gain, was subject to invasion to an extent which could in no event consume it all.

(2) The Remaining Provisions of the Trust Do Not Defeat the Deduction.

In addition to the provisions of the discretionary clause, the corpus of the trust was also subject to the payment of costs, expenses, and taxes mentioned in Article VII(a) of the trust and to the payment of $104,000.00 in specific bequests, all on the death of the life beneficiary [Tr. 28, 29]. These charges existed before and after the realization of the capital gains and could in no event be affected thereby. No possibility suggests itself whereby the payment of these charges would so invade corpus as to deprive the charitable remaindermen of the benefit of the capital gains. In fact the cases cited in the note under point I, A, supra, indicate that such a diversion of corpus will not defeat the deduction. Respondent in auditing petitioner's return for 1936 conceded that capital gains arising out of a sales to secure funds to pay these bequests and charges were deductible [Tr. 9].

The Board of Tax Appeals suggested that the provision for such payments would defeat the deduction,

and cited *Bank of America Nat'l Assn., Trustee,* 19 B.T.A. 1273 [Tr. 38]. In that case, however, the Board said:

> "The facts are that in 1926 the amount of the principal of the trust was sufficient to provide a considerable sum for the next of kin and if we were to deal with probabilities it would be reasonable to say that the profits of $27,874.81, and also future capital gains, would effect merely an increase in the amount left to the next of kin." [19 B.T.A. at p. 1279].

So here it would be unreasonable to say that the capital gain of $32,785.40 would effect an increase in the amount left to anyone other than the charitable remaindermen.

It is respectfully submitted that a consideration of the provisions of the trust involved together with the applicable facts and circumstances demonstrates that the capital gains realized in 1935 are deductible under the provisions of section 162(a) of the Revenue Act of 1934.

II.

ALL CAPITAL GAINS EXCEPT POSSIBLY $3070.62 WERE ACTUALLY RETAINED IN THE TRUST FOR THE CHARITABLE REMAINDERMEN.

The return and tax for the calendar year 1935 were due March 15, 1936 [Revenue Act of 1934, sections 53(a)1 and 56].

The life beneficiary died January 25, 1936 [Tr. 7]. Consequently at the time the tax was due all facts

concerning the actual invasion of the corpus of the trust, either pursuant to or contrary to the terms of the trust, were known and determined. The Board relies on the actual diversion of funds to sustain its conclusions. If the facts are examined it appears that in no sense were all of the capital gains diverted from charitable uses.

An analysis of the transactions giving rise to the capital gains and the amounts expended from corpus [Tr. 51 and 52] reveals that the last payment from corpus which was not by way of reinvestment or not compensated for by way of correction of error was made on August 31, 1935. For the few days of her life in 1936, the life beneficiary was paid $5000.00 from income [Tr. 54]. Prior to and including August 31, 1935, there was paid to the life beneficiary $9545.80, and $100.00 in attorney's fees. The gross capital gains prior to that date were, however, but $4241.95. Of this sum $1171.33 of the $2525.00 realized February 5, 1935, must have been necessary for and used for the investment made February 13, 1935, which leaves a balance of $3070.62 possibly available for diversion. All of the rest of the capital gains were reinvested and so were actually set aside for the charitable remaindermen. The gross capital gains should be adjusted for that percentage which is not recognizable, and it can well be argued that the disbursements made should be prorated between gains and return of cost. Nevertheless, in the absence of other evidence, it is sufficient to say that petitioner by no stretch of the imagination should be taxed on more than $3070.62.

In short, while petitioner does not acquiesce in the theory of the Board of Tax Appeals (see point I above), if the theory is to be applied, it should be applied with all of its logical implications. If actual diversion makes the gains, the benefit from which accrues to charitable purposes, taxable, the tax should extend no further than the total of the actual diversions, at least in a case like this where all possibility of further diversion has passed before the tax for the year in question is due.

III.

IF THE INCOME IS NOT HELD FOR THE CHARITABLE REMAINDERMEN IT IS TAXABLE TO THE GRANTOR-LIFE BENEFICIARY OF THE TRUST.

Petitioner contends that pursuant to the terms of the trust instrument the capital gains were set aside or to be used for charitable purposes so as to entitle it to a deduction. Respondent and the Board of Tax Appeals have taken the position that petitioner is not entitled to the deduction because the gains were subject to other uses, non-charitable in nature. If the gains were not set aside for the charities that very fact itself would relieve petitioner of the tax. The life beneficiary of the trust, in whose favor the discretionary clause was created, was also a grantor of the trust [Tr. 5, 27 and 28]. If income, in the form of capital gains, was paid to her, or accumulated for her benefit, rather than for the benefit of the charitable remaindermen, it should have been taxed to her and not to the trust.

A. IN SO FAR AS INCOME WAS REALIZED BY THE TRUST IN THE FORM OF CAPITAL GAINS AND PAID TO THE LIFE BENEFICIARY IT WAS DEDUCTIBLE UNDER SECTION 162(c) OF THE REVENUE ACT OF 1934.

Section 162 (c) of the Revenue Act of 1934 provides:

> "* * * in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is properly paid or credited during such year to any * * * beneficiary."

If, as contended by respondent, petitioner, in the exercise of its discretion, properly paid a portion of the capital gains realized in 1934 to the life beneficiary, the income represented thereby should be allowed as a deduction within the above section.

B. IN SO FAR AS INCOME WAS REALIZED BY THE TRUST IN THE FORM OF CAPITAL GAINS AND ACCUMULATED FOR THE GRANTOR-LIFE BENEFICIARY, IT WAS TAXABLE TO HER AND NOT TO THE TRUST.

In so far as income was realized by the trust in the form of capital gains and accumulated, it was either accumulated, and so was set aside, for the charitable beneficiaries as heretofore asserted, or was accumulated in a fund to be held for the benefit of the life beneficiary under the discretionary clause. In as much as the life beneficiary of the trust was a grantor of the trust the provisions of sections 166 and 167 of the Revenue Act of 1934 and the principle of *Helvering*

v. Clifford, 309 U.S. 331, 84 L.Ed. 788, become applicable.

Section 167 provides:

> "(a) Where any part of the income of a trust—
>
> "(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or
>
> "(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or * * *
>
> "(b) As used in this section, the term 'in the discretion of the grantor' means 'in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question'."

Rollins v. Helvering (C.C.A. 8) 92 F. (2d) 390 (certiorari denied 302 U.S. 763, 82 L. Ed. 592) involved taxation of capital gains accumulated in the trust. The commissioner contended they were taxable to the grantor. The trust provided:

> "The trustee may from time to time apply to the use of myself, and my descendants, or any of us, so much of the principal of the trust as in its discretion it may deem advisable for our proper education, care, comfort and support."

The grantor in that case also reserved the right to appoint himself trustee. The interest of the trustee,

even if not the grantor, is not, however, a substantial adverse interest in the disposition of the trust income or corpus (see *Reinecke v. Smith,* 289 U.S. 172, 77 L. Ed. 1109).

The grantor also had reserved a right to change the beneficial interests in the trust commencing at a time immediately on the termination of the taxable year in question. It was argued, as in this case, that the discretion given the fiduciary was subject to legal control and could not be exercised arbitrarily. The Court found that in view of the grantor's power to appoint himself trustee and the economic threat to any complaining beneficiary which was embodied in the grantor's reserved power to change such beneficiary's rights in the future, the grantor had the power to distribute the capital gains to himself during the taxable year.

The Court said:

> "When every motive to normal human conduct convinces that a temporary legal right exists under such conditions that it would not be exercised, we cannot treat that right as an effective bar to a duty enjoined by law. We must be governed by actualities—particularly in tax matters. Burnet v. Wells, 289 U.S. 670, 678, 53 S.Ct. 761, 764, 77 L.Ed. 1439; Reinecke v. Smith, 289 U.S. 172, 177, 53 S.Ct. 570, 572, 77 L.Ed. 1109. We must hold that, in every real and practical sense, these instruments gave power to the petitioners to distribute or not distribute to themselves these capital gains in the tax year 1929. Having such power, they had a 'discretion' so to do within the meaning of section 167."

The reasoning advanced parallels the contention made by the respondent and upheld by the Board here:

> "Petitioners contend that since this invasion of corpus had the consent of the remaindermen, the charitable institutions, it is no proof that the life tenant was within her legal rights in demanding the payments from corpus. This may or may not be true, since the consent of the beneficiaries in despite of their financial interest might well proceed from a recognition on their part that a litigated contest would result unfavorably to them. But, be that as it may, our question is 'a factual one', Helen G. Bonfils, supra; not what were the legal rights of the parties but what were the actual probabilities. And if the consent of the remaindermen to the invasion of corpus was obtained in one year, there would be no reason to assume that it would not be forthcoming, as in fact it was, in the next." [Tr. p. 38].

Consequently if the respondent and the Board are correct the conclusion reached in the *Rollins* case is determinative here, and the income was taxable to the grantor-life beneficiary and not petitioner.

See also:

Mary E. Wenger, 42 B.T.A. 225 (on appeal to C.C.A. 6);

Georgia B. Lonsdale, 42 B.T.A. 847.

Compare:

Katharine Boyd Morehead, 42 B.T.A. 851 (on appeal to C.C.A. 3);

Francis S. Willson, 44 B.T.A. .... No. 93 (May 27, 1941).

White v. Higgins (C.C.A. 1) 116 F. (2d) 312 was a suit for refund of taxes paid by the grantors of several trusts on income which they contended should be taxed to the trusts. Each trust consisted of life insurance on the life of the grantor's spouse and of securities, the income of which was to be used to pay premiums on the insurance. Each trust named the grantor and a corporate trust company as trustee, but contained provisions whereby the grantor could constitute himself sole trustee. Each trust was expressed to continue until three years after the death of its grantor's spouse, with accumulation of income not needed for premium payments in the interim. Each trust further provided:

> "* * * if at any time during the continuance of this trust and during the lifetime of [the grantor's spouse] the Trustees shall deem it wise so to do they may use any of the funds in their hands specifically including the cash surrender value of said policy for the benefit of [the grantor and her issue] by paying out to her and them, or any one or more of them, such sums or sum out of the principal as they shall deem necessary or advisable for the comfort, maintenance, support, advancement, education or welfare of [the grantor] and said issue or any or more of them, or they may assign said policy and the trust property to said [grantor], in which case the trust shall cease and determine."

More liberal provisions permitted the distribution of corpus during the three year period following the death of the grantor's spouse.

On a prior appeal (93 F. (2d) 357) the same Court had considered the taxability of the income to the grantors pursuant to sections 219 (g) and 219 (h) of the Revenue Acts of 1924 and 1926 (43 Stat. 277, 44 Stat. 34; the precursors of sections 166 and 167 referred to above). Its conclusions on the first appeal are recited in the second appeal as follows:

> "We construed Article Third of the trust instrument, above quoted, as not conferring upon the trustees an absolute power to surrender the trust property to the grantor and thus terminate the trust, but rather as vesting in them a fiduciary power requiring a determination by the trustees that they deemed it necessary or advisable to use the principal for the comfort, maintenance, support, advancement, education and welfare of Clara C. Higgins or of any issue of her and John W. Higgins, or to surrender and assign the trust property to her. Since this was a power not vested in the grantor as grantor but only in herself as trustee, for so long as she remained a trustee, this court considered that the present was not a case 'where the grantor * * * has * * * the power to revest [the corpus] in himself', within the meaning of Section 219 (g). A similar conclusion was reached as to Section 219 (h)." [116 F. (2d) at p. 316].

This conclusion was allowed to stand under the doctrine of "law of the case", but was disapproved by the Court then acting. The Court then considered the liability of the grantors under section 213(a) of the Revenue Acts of 1924 and 1926 (43 Stat. 267, 44 Stat. 23; the precursor of section 22(a) of the Revenue

Act of 1934), as interpreted by *Helvering v. Clifford,* 309 U.S. 331, 84 L. Ed. 788. The Court looked to the management power retained by the grantor, and the fact that she would ultimately benefit from the trust, and finally to her power under the discretionary clause of the trust, and concluded as follows:

> "Under Article Third, if she as trustee should deem it advisable for her own 'comfort, maintenance, support, advancement, education or welfare', she is empowered to pay over to herself individually the whole or any part of the corpus. Granting that these are fiduciary powers, so were the powers of control over investment which the court regarded as significant in the Clifford case. With such a vague criterion of judgment prescribed in the trust instrument, it is highly improbable that anyone could successfully invoke the power of a court of equity to upset a decision by Mrs. Higgins as trustee to terminate the trust by assignment of the trust property to herself individually. It is equally improbable that any one of the 'intimate family group' would ever attempt to do so. In the Clifford case the court said (309 U.S. at page 335, 60 S. Ct. at page 557, 84 L.Ed. 788) that the grantor 'has rather complete assurance that the trust will not effect any substantial change in his economic position. It is hard to imagine that respondent felt himself the poorer after this trust had been executed or, if he did, that it had any rational foundation in fact'. This quotation seems applicable to the cases at bar. If the emphasis is on economic realities, the reasons for taxing the income to the grantors in the present cases are at least as strong as in the Clifford case." [116 F. (2d) at p. 320].

In this case the grantor-life beneficiary had no such powers of management, as the grantor in the *White* case. Nevertheless respondent contends and the Board found that the income herein in question was not set aside for the charitable beneficiaries because it would in all probability be used for the grantor-life beneficiary, and that the consent of the charitable beneficiaries would be forthcoming in the future. The Board looked to what it termed "actual events" and described the question as " 'a factual one' " (Tr. 37, 38).

It is submitted that if these findings of the Board be sustained, the conclusion must be that there was no effective curb on the power of the grantor-life beneficiary to demand and secure payments from the corpus of the trust. In so far as she had such a power the income in the form of capital gains subject thereto should be taxed to her, and hence is not taxable to petitioner.

1936.

SUMMARY.

For the year 1936 the question involved is the inclusion in the net income of petitioner of amounts disbursed by it (1) out of principal, in compromise of an alleged liability for contribution on account of estate taxes assessed against the estate of the first trustor, and (2) out of income, for attorneys' fees for services in securing a reduction in said estate taxes. Respondent contends that the foregoing sums should have been

paid from income, and consequently disallowed a deduction of the sums actually paid by petitioner, from income, to the charitable beneficiaries.

As stated above, petitioner has withdrawn its claim that the amount of the attorneys' fees was deductible as a business expense. Herein petitioner contends: (1) that the amount paid by way of compromise was properly paid from principal (Point I); and (2) that all of the amounts disbursed are deductible as amounts paid for charitable purposes (Point II).

I.

THE AMOUNT PAID THE ESTATE OF JOHN TONNINGSEN WAS PROPERLY PAID FROM THE PRINCIPAL OF THE TRUST.

On June 30, 1936, petitioner paid $18,533.86 to the executors of the Estate of John Tonningsen, and charged the same to the principal of the trust. During the same year petitioner paid the charitable beneficiaries $17,178.44 and charged this amount to the income of the trust. Respondent contends that the former sum should have been paid from the income of the trust. He therefore reduced the deduction claimed by petitioner for income paid to the charitable remaindermen of the trust, on the ground such income was erroneously so paid, and included in the taxable income of petitioner the sum of $13,496.63. This last sum being the proportion of the total paid to the executors represented by taxable as distinguished from exempt income [Tr. 12, 13, 53-56, Exhibit H].

The Board concluded that the sum paid was a payment of estate tax, that the trust deed required the payment of estate taxes out of income if the income in the year they are paid is sufficient therefor; and that the payments to the charitable remaindermen were not, therefore, pursuant to the terms of the trust [Tr. 39, 40].

Petitioner has attacked these findings in so far as they embody conclusions of fact and law or either, and the failure of the Board to find that petitioner properly accounted for the principal and income during the year in question [Statement of Points, 1936, II, A (1), (2), (3), (4), II C, III A (1), (2), (3), (4), III C, and IV; Tr. 22-25].

The facts disclose that the trust instrument provides as follows in regard to the administration of the trust after January 25, 1936, the date of the death of the life beneficiary [Tr. 5, 7, 28-30]:

> "*upon the death of the survivor* of the Trustors, the Trustee shall administer the trust thereof in the manner following, to-wit:
>
> "(a) Out of the income of the trust fund and estate, *if that be sufficient, or out of the principal thereof, if necessary,* the Trustee shall pay the costs and expenses *of the surviving Trustor's* last illness and of his or her funeral and burial, unless other provision shall have been made therefor, and the inheritance tax upon all distributive shares of or interests in the trust fund and estate, if any be due, and any Federal Estate Tax due upon the whole thereof, and the costs and expenses of the Trust, including the compensation of the Trustee

and all preferred claims or charges against the trust estate, including interest thereon, and the Trustee, during the continuance of this Trust, shall, in its absolute discretion, devote such sums as it may deem necessary for the care and upkeep of the Pierre and Pauline Somps Vault in Holy Cross Cemetery, San Mateo County, California: said vault is presumably to be cared for under a contract providing for perpetual care thereof, but if, for any reason, said vault should not be properly cared for, the Trustee is urged to and authorized to make any necessary repairs thereto.

"(b) *Out of any undistributed income* and/or principal of the trust fund and estate, the Trustee shall make the following payments: [A direction for payment of $104,000 to specific individuals.]

"(c) *Out of the net income of the trust fund and estate not required for any of the purposes aforesaid,* the Trustee shall make the following payments: [A direction for payment of annuities aggregating $600 per month.]

"(d) The Trustee shall pay over *all of the net income of the trust fund and estate, not required for any of the purposes aforesaid,* in perpetuity, as follows: [A direction is made for the payment of the income in equal shares to six organizations qualifying as charitable organizations under the applicable provisions of the Revenue Act.]" (Italics added.)

The facts in connection with the payment made are that it was made to the executors of the estate of the first trustor at a time almost three years after his death, by way of compromise of a dispute over the

liability of the trust for taxes arising by virtue of his death. The life beneficiary and surviving trustor died on January 25, 1936. It was not until June 12, 1936, that petitioner and the executors signed the agreement, pursuant to which the payment was made, in which it was recited as follows [Tr. 10-12, 57-60, Exhibit I]:

> "* * * * * * *
>
> "Whereas, prolonged controversy has existed between the parties hereto with respect to liability for the payment of the Federal estate tax due in the Estate of John Tonningsen, deceased; and
>
> "Whereas, said parties desire a speedy and final determination of the Federal estate tax in the Estate of John Tonningsen, deceased, and with respect to the trust above referred, in accordance with the tentative determination above mentioned, and desire further to amicably adjust the controversy above referred in order to avoid the expense and uncertainty of delay and litigation;
>
> * * * * * * *
>
> "(3) It is expressly agreed and understood that this agreement is intended by way of compromise between the Trustee and the Executor of the controversy above referred to, is expressly limited thereto and shall not constitute, or be deemed, or be used in any proceedings as, an admission on the part of the Trustee of liability, nor preclude the Trustee from hereafter denying any liability, for payment, reimbursement, or contribution of any tax whatever under any circumstances, except liability for payment by way of compromise pursuant to and subject to the terms and conditions of this agreement.
>
> * * * * * * *

"On the part of the Trustee this agreement is conditional upon and subject to assent thereof by the charitable beneficiaries of the trust, in writing, in terms satisfactory to the Trustee."

Thereafter the charitable remaindermen consented to the agreement [Tr. 12, 60-61, Exhibit J].

It must be remembered that it is the intent of Congress to encourage charitable contributions [see 1935, point I A supra]. In *Old Colony Trust Co. v. Commissioner,* 301 U.S. 379, 81 L. Ed. 1169, one of the issues presented, and the conclusions thereon, are stated as follows:

"We are asked to hold that the words 'pursuant to' mean directed or definitely enjoined. And this notwithstanding the admission that Congress intended to encourage charitable contributions by relieving them from taxation. Lederer v. Stockton, 260 U.S. 3, 67 L. ed. 99, 43 S. Ct. 5; United States v. Provident Trust Co., 291 U.S. 272, 285, 78 L. ed. 793, 979, 54 S. Ct. 389.

" 'Pursuant to' is defined as 'acting or done in consequence or in prosecution (of anything); hence, agreeable; conformable; following; according'.

"The words of the statute are plain and should be accorded their usual significance in the absence of some dominant reason to the contrary" [301 U.S. at p. 383, 81 L. Ed. at p. 1173].

The question therefore is whether the payment of income to the charities was "agreeable", "conformable", "following" or "according" to the terms of the trust instrument. Or, conversely, did the trust instru-

ment absolutely require the use of this income for other purposes. It is submitted not only that the Board's construction of the instrument is erroneous, but also that the Board erred in concluding that petitioner would not be entitled in the exercise of its discretion to pay this sum from principal.

A. PETITIONER WAS NOT REQUIRED TO MEET EXTRAORDINARY CHARGES OUT OF INCOME ACCRUING AFTER THE SURVIVING TRUSTOR'S DEATH.

The income to be paid to the charitable beneficiaries is "all of the net income of the trust fund and estate, *not required for any of the purposes aforesaid* [Article VII (d) italics added]. Going backward to determine the purposes aforesaid it appears that the trustors directed $600 per month to be paid to annuitants "out of the net income of the trust fund and estate *not required for any of the purposes aforesaid"* [Article VII (c), italics added]. The charges prior to this clause are for the payment of $104,000 to specific individuals "out of *any undistributed income* and/or principal" [Article VII (b), italics added]. $100,000 net was so paid out by petitioner out of principal as augmented by the $4992.22 income on hand at the date of the death of the life beneficiary, and no question has been raised in regard thereto.

It is the provisions for payment of the charges set forth in Article VII (a) which respondent contended and the Board found defeated the rights of the charities under Article VII (b). That section provides for payment "out of the income of the trust fund and estate, *if that be sufficient, or out of the principal*

thereof, if necessary" (italics added). The holding of the Board could not be questioned if the italicized words had been omitted. They were used by the trustors, however, and consequently must be given some effect. This factor was apparently in the Board's mind when it said:

> "The income of the trust for the year 1936 was sufficient to pay the estate taxes and attorneys fees in question. The trust deed requires that under those circumstances they be paid out of that income" [Tr. 40].

There is nothing in the trust deed which justifies the conclusion that the "sufficiency" of income or the "necessity" of resorting to principal to meet the charges mentioned in Article VII (a) is to be gauged by the amount of income realized in the calendar year 1936, or is to be gauged by the amount of income realized in the particular calendar year when the charge becomes payable, or for that matter, to be gauged by the amount of income realized in the particular calendar year when the trustee elected to pay the charge regardless of its due date. The determination of the "sufficiency" and "necessity" referred to above by such standards shows a preoccupation with the taxable incidents of income which, although a proper attribute of the reasoning of respondent and the Board, it would be unwarranted to attribute to the settlors of this trust. It is manifest that it was their intention to provide for the payment of the just charges against the trust estate, and to distribute the balance of the estate created, both income and principal, to the objects of their benefaction.

With this thought in mind it is apparent that the "sufficiency" of the income and the "necessity" of resorting to principal should be determined as of the date of the death of the surviving trustor. In the first place all of the payments to be made pursuant to the provisions of paragraphs (a), (b), (c) and (d) of Article VII relate back to one time—"the death of the survivor of the Trustors". In the second place under the provisions of paragraph (c) the payments from income to specific annuitants are prefaced by the same condition as is in question in regard to the charitable beneficiaries—"out of the net income * * * not required for any of the purposes aforesaid". Should petitioner have delayed the enjoyment of income by those beneficiaries for one year, or until sufficient income was realized to take care of all possible contingent charges? Under the law of the State of California a bequest of income passes the income from the date of death [California Probate Code, section 60]. The same principle should be applicable to a testamentary trust. It cannot be said that an interpretation which gives those entitled to income under paragraphs (c) and (d) that income from the date of the survivor is unreasonable, or unjustified in view of the discretion vested in the trustee to determine whether or not it is necessary to resort to principal for the payment of other charges. Moreover payment of extraordinary charges out of principal is expressly warranted by the law of the State of California. In *Estate of Kruce,* 10 Cal. App. (2d) 426, 51 P. (2d) 1174, the Court stated:

> "The will provided for the payment of the net income to the daughter *after deducting all neces-*

sary taxes, costs and expenses, including the compensation of said trustees, the same to be paid in monthly instalments. It is appellants' contention that under this provision of the will the court was bound to charge the expenses in question to income. We do not agree that the will should be given this construction. *It is not questioned that in the absence of contrary testamentary directions the ordinary and current expenses of a trust, including the trustees' compensation, should be paid out of income and that extraordinary and unusual charges should be paid from the corpus of the estate* (In re Woods, 6 Cof. Prob. Dec. 451; Estate of Dare, 196 Cal. 29, 42 [235 Pac. 725]; Estate of Gartenlaub, 185 Cal. 648, 655 [198 Pac. 209, 16 A.L.R. 520]). We do not think the provisions of the will depart from this rule. The direction of the will would seem to apply to the current compensation and expenses of the trustees and not to anything of an extraordinary nature. The services for which the allowances were made consisted of closing the trust and distributing the property remaining therein after the death of the life tenant. They were performed necessarily for the benefit of the remaindermen and were unrelated to the management of the trust for the benefit of the life estate. They were not such ordinary and current expenses as would have to be deducted from the income periodically in order that the net income might be computed and paid to the life tenant each month as directed by the will [126 Cal. App. (2d) at p. 430, 51 P. (2d) at p. 1176, italics added]."

Finally if the words "not required for any of the purposes aforesaid" were to be given the rigid con-

struction indicated by the Board, with complete disregard of the other provisions of Article VII, it would follow that the enjoyment of the beneficiaries named in paragraphs (c) and (d) should be postponed to the payment of those mentioned in paragraph (b). The action of petitioner in paying these sums from principal pursuant to the words "out of any undistributed income and/or principal" has not been questioned. If petitioner had discretion to determine what is undistributed income under that clause, it certainly had discretion to determine the sufficiency of income and necessity for resort to principal under the provisions of paragraph (a).

B. THE PAYMENT MADE WAS NOT WITHIN THE SCOPE OF THOSE REFERRED TO IN ARTICLE VII(a).

Even if it be assumed that the trust should be construed so as to require petitioner to accumulate income to meet the charges specifically mentioned in paragraph (a), there is no warrant in extending the provisions of that paragraph to other extraordinary payments.

Paragraph (a) refers to "the inheritance tax upon all distributive shares of or interests in the trust fund and estate, if any be due, and any Federal Estate Tax due upon the whole thereof * * * and all preferred claims or charges against the trust estate, including interest thereon".

The payment in question was not made by virtue of any governmental demand for inheritance or estate taxes, nor was it made to any person or instrumentality

claiming a preferred claim or charge on the trust estate. The only liability for taxes involved was that asserted against the estate of the first trustor in the hands of his executors. The payment was made in compromise of an alleged claim for contribution made by said executors. It was not made pursuant to the trust, but with doubt of its propriety, and only with the consent of the charitable remaindermen.

Furthermore even if payment for such a purpose could be considered payment of a tax or a preferred claim, the provisions of the trust demonstrate that the only taxes or preferred claims referred to were those arising by virtue of the death of the survivor. If the first trustor died prior to his wife he wanted her to have the net income less only the costs and expenses of the trust estate [Article IV, Tr. 27]. Consequently taxes due from his estate were to be met therefrom. Article VII only deals with the administration of the trust "upon the death of the survivor of the Trustors". The construction of the trust instrument should not depend on the chance that the survivor should die before taxes against the first to die were settled. If this factor is eliminated it is clear that the taxes and charges mentioned in Article VII, paragraph (a) are those arising on the death of the survivor. Certainly the governmental agencies, or the executors of the estate of the first trustor, if they had a valid claim, could not be compelled to defer the collection thereof until the surviving trustor should die, and then until sufficient income was realized. Since the payment did not relate to taxes or charges arising on the death of

the surviving trustor, the provisions of paragraph (a) are inapplicable, and petitioner properly made payment out of principal in accordance with the general law cited above.

C. THE PAYMENT WAS NOT MADE PURSUANT TO THE TERMS OF THE TRUST, BUT ASIDE THEREFROM.

In connection with the issue for 1935 the Board of Tax Appeals stressed the fact that the charitable remaindermen had consented to payments from principal and thereby changed the nontaxable incident of income devoted to charities. As shown above those payments could in no sense be deemed pursuant to the terms of the trust.

In the present case there was also no express warrant for the payment involved. It was made, however, with the consent of the charitable remainderman. If, as referred to above, their action determines the taxable incidents of the payment made, their consent and acquiesence in the action taken by petitioner in connection with the payment to the executors should determine this issue. They authorized the payment, and after it was made received and retained the income which respondent contends should have been used therefor.

In short if actualities, over petitioner's objections, are to govern for the determination of the issue for the year 1935, they should equally control the issue herein discussed.

II.

THE PAYMENTS FOR ATTORNEYS' FEES AND TO THE EXECUTORS DO NOT REPRESENT TAXABLE INCOME, AS THEY ARE SUMS PAID FOR CHARITABLE PURPOSES.

At the time the attorneys' fees and the compromise payment were satisfied the trust was administered, with the exception of $7200.00 a year from income, solely for the benefit of the charitable remaindermen. At the time of the threat of an increased liability of the estate of the first trustor for additional estate taxes, and the claim of the executors of his estate for contribution therefor, it was apparent that the loss, if any there was, would fall on the charitable remaindermen. The attorneys' services served to cut down the threatened tax liability, and the compromise payment, actually made with the consent of the charitable beneficiaries, served to protect and enhance the estate inuring to the benefit of the charitable purposes stressed by the trustors.

The attorneys' fees were paid from income, and it is urged by respondent that the compromise payment should have been so paid. If so paid were they not paid for charitable purposes? It is true that the mere fact that income is used to relieve corpus destined for charitable purposes of other charges will not make such income deductible [*Commissioner v. Bonfils* (C.C.A. 10) 115 F. (2d) 788 at p. 793]. In that case the income was used to pay annuities to other objects of the testator's bounty. Here, however, the income was not used to carry out private benefactions of the trustors, or, as might otherwise be the case, to pay the just obligations of the trustors, but solely for the

purpose of protecting and preserving a fund which is within the protection of the beneficient purpose of Congress. Certainly a charitable organization does not lose its immunity from direct income taxation because it uses its funds for such mundane purposes as hiring counsel to protect its property rights, or compromising asserted claims against it. So, here, income, which, though not paid directly to charitable organizations, is paid for their sole use and benefit should come within the statutory provisions [Section 162a of the Revenue Act of 1936].

CONCLUSION.

The fundamental issues for both years are practically the same. On the one hand the tax laws and the policy behind them, as enumerated by the Courts, have consistently scrutinized trust relationships in an effort to prevent resort to devices which would permit taxable income thereby devoted to private purposes from escaping its just contribution to the expenses of government. On the other hand, Congress and the Courts have just as consistently manifested the principle that income and property devoted to charitable purposes should enjoy immunity from such burdens.

In this case respondent and the Board of Tax Appeals have disregarded salient facts, and by judicious selection of particular facts, and particular provisions of the trust instrument propose to tax income the benefit of which inures solely to charitable purposes. For the year 1935 a small portion of the principal of

the trust was devoted to noncharitable purposes. Without deciding whether or not such diversion was justified under the provisions of the trust, the Board seized on this fact alone to justify the imposition of a tax on income which it was demonstrated both actually, and pursuant to the terms of the trust, inured for the benefit of charitable organizations. For the year 1936 the Board seized on one clause of a general section of the trust agreement, and overrode the practical interpretation thereof and the actual administration of the trust by petitioner as acquiesced in by the beneficiaries, in order to sustain a tax on income in part actually paid to charitable organizations, and unquestionably all paid or payable for charitable purposes.

It is respectfully submitted that the findings of fact and conclusions of law of the Board of Tax Appeals should be set aside, and reversed, and that an order be made here or below setting aside respondent's proposed determination.

Dated, San Francisco,
August 15, 1941.

J. W. Radil,
F. J. Kilmartin,
R. M. Sims, Jr.,
Knight, Boland & Riordan,
Attorneys for Petitioner.

(Appendix Follows.)

Appendix.

Appendix

Revenue Act of 1934, section 22(a):

"§ 22. Gross Income

(a) General Definition. 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. In the case of Presidents of the United States and judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income; and all Acts fixing the compensation of such Presidents and judges are hereby amended accordingly."

Revenue Act of 1934, section 23(o):

"§ 23. Deductions from Gross Income

In computing net income there shall be allowed as deductions:

* * * * * * *

(o) Charitable and Other Contributions. In the case of an individual, contributions or gifts made within the taxable year to or for the use of:

(1) the United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;

(2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

(3) the special fund for vocation rehabilitation authorized by section 12 of the World War Veterans' Act, 1924;

(4) posts or organizations of war veterans, or auxiliary units or societies of any such posts or organizations, if such posts, organizations, units, or societies are organized in the United States or any of its possessions, and if no part of their net earnings inures to the benefit of any private shareholder or individual; or

(5) a fraternal society, order, or association, operating under the lodge system, but only if such contributions or gifts are to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals;

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary."

Revenue Act of 1934, section 162:

"§ 162. Net Income

The net income of the state or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23(o) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23(o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of ad-

ministration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary."

Revenue Act of 1934, section 167:

"§ 167. Income for Benefit of Grantor

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purpose and in the manner specified in section 23(o), relating to the so-called 'charitable contribution' deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term 'in the discretion of the grantor' means 'in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question'."

Revenue Act of 1936, sections 23(o) and 162:

[Same text as Revenue Act of 1934, above].